



State of Utah

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To: Workforce Services and Community and Economic Development Interim Committee

From: Utah Department of Workforce Services, Unemployment Insurance Division
Bill Starks, Unemployment Insurance Director

Subject: 2006 Master Study List #181, Unemployment Contributions by Certain Corporations

A request was filed "to study whether principals of small S corporations, which are not eligible for unemployment benefits, should be required to contribute to the State Unemployment Insurance Fund." This memo will hopefully clarify the subject of whether corporate officers are eligible to draw Unemployment Insurance (UI) benefits that are unemployed and whether their wages should be subject to Utah UI contributions (taxes).

Typically a corporate officer is not entitled to UI benefits if the corporation is not closed. A corporation, like any other business entity, may have periods of little or no activity, however in most cases the officers of the entity are actively spending time trying to build the business or preparing for the next seasonal cycle of the business. Section R994-207-101 states, "It is not the intent of the fund to subsidize a claimant who is devoting substantially all his time and efforts to starting up a new business or expanding an existing business even though he receives no income." In the event the corporation closes and there is no intent to re-open in the foreseeable future, the corporate officer would generally be eligible for UI benefits.

The following elements are required to qualify for UI benefits:

- The claimant must be working less than full time but working all the hours reasonable for him or her to work.
- The claimant must be earning less than his or her weekly UI benefit amount.
- The claimant must be available for and seeking other full-time suitable work.

Section R994-207-102 states, "The efforts of a claimant to seek work should be distinguished from those directed towards obtaining work for himself as an individual and those directed toward obtaining work or customers for his corporation or business. Efforts to obtain work for the business or corporation are evidence of continuing responsibilities but are not evidence of an individual's active search for other employment as required for eligibility."

The subject of excluding corporate officers from state unemployment tax has been addressed repeatedly in the past. The law is clear that neither C Corporation nor S Corporation Officers are exempt from coverage under the Federal Unemployment Tax Act (FUTA) or State UI taxes.

Section 35A-4-204 of the Employment Security Act states, “employment means any service performed for wages or under any contract of hire, whether written or oral, express or implied, including service in interstate commerce, **and service as an officer of a corporation.**”

Rule 994-202-101 (3) further states, “**All individuals employed by the corporation, including officers, are employees.** Compensation to officers who perform services necessary to the corporation is deemed to be wages. Payments to corporate employees such as dividends, loans and expenses in lieu of compensation for services may be reclassified as wages by the department. Reclassification will be based upon the extent and significance of the work performed and the documentation supporting such payments. **This applies to all corporations regardless of income tax reporting status.**”

Excluding officers from state coverage has the following consequences:

- Employers would generally have to pay more taxes because there is no FUTA exclusion for corporate officers. Section 3306(c) of the Internal Revenue Code defines employment as “any service, of whatever nature, performed after 1954 by an employee for the person employing him...” That section then goes on to list twenty plus types of employment that are excluded from this definition. Corporate officers are not one of the exclusions. The Federal tax is 6.2% for all employers. Employers get a 5.4% credit against the Federal tax if they pay their state unemployment tax. They get a full 5.4% credit regardless of what their state rate actually is, which could be as low as .4%. If there were a state exclusion for corporate officers, employers would have to pay the full 6.2%, of the first \$7,000 of each employee’s wages, to the Internal Revenue Service (IRS).
- The majority of Utah employers could ultimately end up paying more total taxes without the benefits of potential U.I. benefits to many workers unemployed due to no fault of their own. All corporate officers are not necessarily owners of the business, even in “S” corporations.
- A critical component of an employers UI tax rate is the ratio of an employer’s “UI benefit charges” to their “UI taxable wages”. Excluding a Corporate Officer’s taxable wages from the ratio would cause the employer’s tax rate to increase if the employer had any benefit charges on their account.

An alternative which somewhat resolves this issue is for employers to consider changing from a corporation to a Limited Liability Company (LLC). Corporate officers would then be “members” of the LLC, which are excluded from state unemployment tax, provided they do not elect to file as a corporate entity with the IRS. The IRS treats an LLC as a partnership or a proprietorship if they do not elect to file as a corporation. Partners and Proprietors are excluded from both FUTA and State UI tax coverage.